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Loan Interest Rates

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Official Title and Summary Prepared by the Attorney General

LOAN INTEREST RATES. LEGISLATIVE CONSTITUTIONAL AMENDMENT. Amends constitutional limit of 10 percent on loan interest rates. Applies 10 percent rate limit to loans primarily for personal, family or household purposes. For other purposes authorizes interest rate limit to be higher of 10 percent or 5 percent plus rate of interest charged by San Francisco Federal Reserve Bank to member banks 25 days prior to execution of loan contract or making of loan. Continues exemption of specified lending institutions from rate restrictions. Extends exemption to loans made or arranged by licensed real estate brokers when secured by lien on real property. Financial impact: No direct fiscal effect on state or local government.

FINAL VOTE CAST BY LEGISLATURE ON ACA 52 (PROPOSITION 2)

Assembly—Ayes, 73
Noes, 5

Senate—Ayes, 33
Noes, 0

Analysis by Legislative Analyst**Background:**

The California Constitution prohibits any lender of money, other than those specifically exempted by the Constitution, from charging interest on any loan at a rate exceeding 10 percent per year. This provision of the Constitution is commonly referred to as the usury law.

The Constitution specifically exempts the following lenders from the usury law: savings and loan associations, state and national banks, industrial loan companies, credit unions, pawnbrokers, personal property brokers and agricultural cooperatives.

Proposal:

This ballot measure would amend the Constitution to make several changes in existing law regarding the level of interest rates that may be charged:

1. Under existing law, loans made or arranged by any person licensed as a real estate broker by the State of California and secured in whole or in part by liens on real property are subject to a 10 percent interest rate ceiling. Such loans commonly are made by mortgage brokers and mortgage bankers. Under this measure such loans would be exempt from the constitutional limitations on interest rates that may be charged.

2. Under existing law, lenders not specifically exempted by the Constitution, such as insurance companies and private individuals, are subject to the 10 percent interest rate ceiling on all of their loans. This measure would retain the 10 percent ceiling on loans made by these lenders if the loans were made for personal, family or household purposes. However, if these loans were made for other purposes, such as the pur-

chase, construction or improvement of real property, or financing business activity, they would become subject to a new ceiling. The new interest rate ceiling on these nonpersonal loans would be the higher of (a) 10 percent per year or (b) the prevailing annual interest rate charged to member banks for moneys advanced by the Federal Reserve Bank of San Francisco, plus 5 percent per year. In June 1979, the interest rate charged by the Federal Reserve Bank was 9½ percent. Thus, the allowable rate on loans made during that month would have been 14½ percent had this measure been in effect.

3. The Legislature would be authorized to exempt any other class of persons from the restrictions on interest rates. Currently, exemptions may only be granted by amending the Constitution, which requires a vote of the people.

4. Under the measure, a loan which is exempt from the provisions of the usury law at the time it is made would continue to be exempt from these provisions even if the loan is sold or transferred to another party. While such a loan generally does not become subject to the limitation on interest rates under existing law, the courts have the authority to review the particular circumstances surrounding the sale or transfer. If the court finds that the transaction violates the intent of existing law limiting the rate of interest that may be charged, it may rule that the loan is subject to the limitation. This ballot measure may restrict the court's authority to make such rulings.

Fiscal Effect:

The proposition would have no direct fiscal effect on state or local governments.

Text of Proposed Law

This amendment proposed by Assembly Constitutional Amendment No. 52 (Statutes of 1979, Resolution Chapter 49) expressly amends an existing section of the Constitution; therefore, existing provisions proposed to be deleted are printed in ~~strikeout type~~ and new provisions proposed to be inserted are printed in *italic type* to indicate that they are new.

PROPOSED AMENDMENT TO ARTICLE XV

SECTION 1. The rate of interest upon the loan or forbearance of any money, goods, or things in action, or on accounts after demand, shall be ~~7 per cent percent~~ per annum but it shall be competent for the parties to any loan or forbearance of any money, goods or things in action to contract in writing for a rate of interest ~~not exceeding 10 per cent per annum.~~ :

(1) *For any loan or forbearance of any money, goods, or things in action, if the money, goods, or things in action are for use primarily for personal, family, or household purposes, at a rate not exceeding 10 percent per annum; provided, however, that any loan or forbearance of any money, goods or things in action the proceeds of which are used primarily for the purchase, construction or improvement of real property shall not be deemed to be a use primarily for personal, family or household purposes; or*

(2) *For any loan or forbearance of any money, goods, or things in action for any use other than specified in paragraph (1), at a rate not exceeding the higher of (a) 10 percent per annum or (b) 5 percent per annum plus the rate prevailing on the 25th day of the month preceding the earlier of (i) the date of execution of the contract to make the loan or forbearance, or (ii) the date of making the loan or forbearance established by the Federal Reserve Bank of San Francisco on advances to member banks under Sections 13 and 13a of the Federal Reserve Act as now in effect or hereafter from time to time amended (or if there is no such single determinable rate of advances, the closest counterpart of such rate as shall be designated by the Superintendent of Banks of the State of California unless some other person or agency is delegated such authority by the Legislature).*

No person, association, copartnership or corporation shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than ~~10 per cent per annum~~ the interest authorized by this section upon any loan or forbearance of any money, goods or things in action.

However, none of the above restrictions shall apply to any obligations of, loans made by, or forbearances of, any building and loan association as defined in and which is operated under that certain act known as the "Building and Loan Association Act," approved May 5, 1931, as amended, or to any corporation incorporated in the manner prescribed in and operating under that certain act entitled "An act defining industrial loan

companies, providing for their incorporation, powers and supervision," approved May 18, 1917, as amended, or any corporation incorporated in the manner prescribed in and operating under that certain act entitled "An act defining credit unions, providing for their incorporation, powers, management and supervision," approved March 31, 1927, as amended or any duly licensed pawnbroker or personal property broker, *or any loans made or arranged by any person licensed as a real estate broker by the State of California and secured in whole or in part by liens on real property*, or any bank as defined in and operating under that certain act known as the "Bank Act," approved March 1, 1909, as amended, or any bank created and operating under and pursuant to any laws of this State or of the United States of America or any nonprofit cooperative association organized under Chapter 1 (commencing with Section 54001) of Division 20 of the Food and Agricultural Code in loaning or advancing money in connection with any activity mentioned in said title or any corporation, association, syndicate, joint stock company, or partnership engaged exclusively in the business of marketing agricultural, horticultural, viticultural, dairy, live stock, poultry and bee products on a cooperative nonprofit basis in loaning or advancing money to the members thereof or in connection with any such business or any corporation securing money or credit from any ~~Federal~~ federal intermediate credit bank, organized and existing pursuant to the provisions of an act of Congress entitled "Agricultural Credits Act of 1923," as amended in loaning or advancing credit so secured, *or any other class of persons authorized by statute, or to any successor in interest to any loan or forbearance exempted under this article*, nor shall any such charge of any said exempted classes of persons be considered in any action or for any purpose as increasing or affecting or as connected with the rate of interest hereinbefore fixed. The Legislature may from time to time prescribe the maximum rate per annum of, or provide for the supervision, or the filing of a schedule of, or in any manner fix, regulate or limit, the fees, ~~bonus~~ bonuses, commissions, discounts or other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower in connection with any loan or ~~forbearance~~ forbearance of any money, goods or things in action.

The rate of interest upon a judgment rendered in any court of this state shall be set by the Legislature at not more than 10 percent per annum. Such rate may be variable and based upon interest rates charged by federal agencies or economic indicators, or both.

In the absence of the setting of such rate by the Legislature, the rate of interest on any judgment rendered in any court of the state shall be 7 percent per annum.

The provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith.

Argument in Favor of Proposition 2

In our society today, every family, individual, and employer faces an occasional need for money.

Because sometimes there are problems in securing that money, and some of those problems are actually *caused* by outdated laws adopted in totally different circumstances, Proposition 2 attempts to eliminate *one* problem area.

The Usury Law of California, adopted in 1934 (during the Depression), limited the price which many lenders could charge for the use of money to 10 percent. Unfortunately, inflation and other factors have made that limit unrealistic.

Because 10 percent is not enough today, many lenders no longer loan money in California (although others who are *now* exempt from the Usury Law still do). For example, mortgage bankers, who last year provided \$13 billion for housing loans in California, are limited to a 10 percent rate and in 1979 have practically abandoned providing conventional mortgage loans.

This *shortage* of money is curtailing the building of new homes, apartments, stores, and factories to provide needed new jobs. Because this reduces competition among lenders, it actually forces interest *up* on money from lenders now exempt from the Usury Law.

Now, it might *seem* good to be able to have a law which limited the price of a loaf of bread to 10 cents; but, if we had such a law, there would be no bread or only black market bread. We are approaching that stage on the availability of *extra* money—for a family to buy a home, an employer to buy a new factory, tools, a store, or some other job-creating opportunity.

Proposition 2 deals with that problem in realistic and *controlled* circumstances.

It is complex and technical because both the law and the money market are complex and technical. Proposition 2 is explained in the Legislative Analyst's analysis in this pamphlet with text of the changes.

An important fact is that this constitutional provision *retains* present provisions enabling a control by law on "the maximum rate per annum" and on fees or other compensation—a vital control against abuse. Proposition 2 removes the arbitrary, inflexible, and unrealistic *constitutional* limits on nonconsumer loans and on exemptions which have severely limited the flow of money to California to buy homes, create job opportunities, and for other purposes.

Cheap money is no good if you can't get it when you need it. In that case, cheap money is no money.

In the last few years, state after state has found it necessary to change its usury law *for* the people in those states. Today, in today's world, California must change too *for* the people of California.

Proposition 2 is endorsed by labor, business, civic, and governmental leaders who have studied this issue and recognize the need. No group and no individual appeared before the legislative committees to oppose this measure, which passed the Senate 33-0 and the Assembly 73-5.

Because sometimes we all need money, we need to remove outdated limitations on the availability of that money. Vote "YES" on Proposition 2.

WALTER M. INGALLS
Member of the Assembly, 68th District

WILLIAM CAMPBELL
State Senator, 33rd District
Senate Minority Floor Leader

No rebuttal to argument in favor of Proposition 2 was submitted.

Argument Against Proposition 2

Proposition 2 would weaken California's usury laws by boosting interest rates on certain loans above the current 10% maximum. Eroding these laws would be a misstep in the direction of higher costs and tighter money.

In both the primary and general elections in 1976, the voters clearly said NO to similar ballot proposals which would have increased interest rates by changing the portion of the California Constitution that has protected consumers for more than 40 years. I ask you to vote NO once again.

Proposition 2 would boost interest rates for other than consumer loans above the current 10% maximum. These maximum interest rates would be tied to the prevailing discount rate or the interest rate which the Federal Reserve Bank charges member banks. Thus, if this measure had been law in July 1979 when the discount rate was at an all-time high of 9½%, the interest rate charged by a nonexempt lender could now be 14½%.

If higher interest rates can be charged on loans to businesses and corporations than can be charged for consumer loans, then obviously there will be a greater incentive to loan more money to corporations. This will take money away from the consumer loan market and could virtually dry it up. Consumer loans will be harder and harder to get.

Proposition 2, contrary to what supporters say, could affect consumer loans. Although loans used primarily for personal, family, or household purposes would be exempt, you could be charged these higher interest rates if under half of the money borrowed is to be used for household needs and over half for some other purpose.

We need our consumer protection laws. Let's keep California's usury laws intact. Let's say NO to higher interest rates. Vote NO on Proposition 2.

HERSCHEL ROSENTHAL
Member of the Assembly, 45th District

Rebuttal to Argument Against Proposition 2

Opponents say that we should deny businesses and corporations the opportunity to pay higher interest rates—a primary purpose of Proposition 2.

Make no mistake; business does not want to pay a penny more in interest than it must—and will not. But, business needs money to build housing, factories, stores, and offices and develop farms and energy sources so that they can create jobs and homes for our growing population.

And today, not enough money is available because of the outdated restrictions of our interest laws applicable to business or nonconsumer loans. California business needs a change to compete fairly for dollars.

Proposition 2 will have essentially no effect on loans for personal, family, or household purposes—such loans will remain subject to the 10 percent interest limit and,

in many cases, are *already* and have always been exempt from constitutional control. Our consumer protection laws will remain essentially unchanged and as strong as they are today.

Conditions today are very different than they were even in 1976, when the voters last examined this issue; and are certainly different than they were in 1934, when this provision was originally written.

We cannot go back to the 10¢ loaf of bread. In realism, California must join other states in making money available for all its citizens.

WALTER M. INGALLS
Member of the Assembly, 68th District

WILLIAM CAMPBELL
State Senator, 33rd District
Senate Minority Floor Leader